Supreme Court, U.S.
FILED
NOV 20 1980
MICHAEL RODAK, JR., CLERK

No. 80-659

IN THE

Supreme Court of the United States

OCTOBER TERM, 1980

MARY LILLIAN ADAMS, in her own name and on behalf of all other persons similarly situated,

Petitioners,

v.

PEAT, MARWICK, MITCHELL & Co.,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

BRIEF OF RESPONDENT IN OPPOSITION TO THE PETITION FOR A WRIT OF CERTIORARI

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November 20, 1980

The "Questions Presented"

In their "Questions Presented", petitioners misstate the holdings of the court of appeals. The decision below does not put in issue the questions which petitioners seek to present.

As one premise for the questions, petitioners say that the court of appeals held that "an accounting firm knowingly made misstatements" (Pet. p. I). In fact, the court of appeals held that the evidence suggested "a mistake" or "at most" negligence (A-10-11) and did not support a finding of "knowing or reckless wrongdoing" (A-14). Petitioners' other premise is that the court of appeals held that the misstatements were of "material facts" (Pet. p. I). The court of appeals actually held that the mistake was a "minor error at the time" (A-11).

All that is left then is the third question which is simply a claim that this Court should give petitioners another hearing on the evidence with respect to scienter.*

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* Respondent Peat, Marwick, Mitchell & Co. received the petition in the mail on October 22, 1980.

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BRIEF OF RESPONDENT IN OPPOSITION TO THE PETITION FOR A WRIT OF CERTIORARI

Statement of the Case

Respondent Peat, Marwick, Mitchell & Co. ("PMM") is a firm of independent certified public accountants. It was held liable for $4,503,385.20 by the district court by reason of a misdescription of contractual restrictions on retained earnings which appeared in one of the footnotes to the 1969 financial statements of Chadbourn, Inc. ("Chadbourn") audited by PMM. The footnote incorrectly stated that Chadbourn was contingently restricted in payment of dividends or other distributions upon its "common" stock when it should have said that the contingent restrictions applied to Chadbourn's "capital" stock.

The misdescription became a bone of contention because of the following sequence of events: (1) the financial statements as at and for the fiscal year ended August 2, 1969 which appeared in Chadbourn's 1969 Annual Report were thereafter reprinted in a March 1970 merger proxy statement for Chadbourn's acquisition of all of the stock of another corporation, Standard Knitting Mills, Inc. ("Standard"), in exchange for a newly issued series of Chadbourn convertible preferred stock; (2) the exchange took place and Chadbourn issued the new preferred stock; (3) almost two years after this transaction, there was a disastrous decline in the market for Chadbourn's principal product which caused Chadbourn to incur an unprecedented loss, wiping out all of its retained earnings; and (4) because of that loss Chadbourn was unable to pay dividends on or redeem the preferred stock it had issued to the former Standard shareholders.

The district court had based its damage award against PMM upon causes of action implied under § 10(b) and § 14(a) of the Securities Exchange Act of 1934 (the "1934 Act"), 15 U.S.C. §§ 78j(b), 78n(a) (1976). The court of appeals reversed, holding (i) that the district court's finding that PMM acted with scienter was "clearly erroneous" (A-10) and (ii) that at the time and in the circumstances in which it was made the footnote error in issue was "a minor error" (A-11). The court of appeals concluded that "[t]he evidence simply suggests a mistake, an oversight" (A-11).

> "At most the evidence supports a finding that Peat acted negligently in preparing the financial statements [in issue]." (A-10)*

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* In this brief "(A-)" refers to pages in the appendix to the petition and "(———a)" refers to pages in the joint appendix filed in the court of appeals.

The record amply supports these conclusions by the court of appeals.

PMM audited the financial statements of Chadbourn for its fiscal year ended August 2, 1969 and based upon that audit rendered an opinion dated October 21, 1969. The financial statements and PMM's opinion were prepared for and appeared in Chadbourn's 1969 Annual Report to its stockholders. Later they were reprinted in several other reports including Standard's March 27, 1970 proxy statement. PMM expended approximately 5500-6000 man hours and employed the services of 25 auditors on its examination (736a, 1834a-35a).

There never was any claim or proof by petitioners that any figure in the Chadbourn financial statements was wrong or that those statements did not fairly present Chadbourn's assets and liabilities and its income and expenses.

A bank loan agreement restricted Chadbourn from using a portion of its retained earnings to pay dividends on or purchase its capital stock, including common and preferred. It left approximately $2 million of retained earnings already accumulated by Chadbourn as well as all of its future earnings available for such purposes (A-5; 2212a-14a). An earlier subordinated debenture indenture also restricted the use of retained earnings to pay dividends, but it left unrestricted in excess of $5 million of past earnings and all future earnings (A-6; 2195a).*

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* While petitioners quote the indenture as restricting the ability of Chadbourn or its subsidiaries to pay dividends (Pet. p. 5), they do not note that as far as ability to redeem stock was concerned, the indenture provided only that Chadbourn "will not permit any subsidiary to" redeem stock (2195a). The loan agreement which did restrict use by Chadbourn itself of a portion of its retained earnings to redeem stock, left approximately $2 million of retained

Hugh Freeze, PMM's audit manager, drafted a footnote to Chadbourn's August 2, 1969 financial statements near the end of the audit in September 1969 to include a description of the new loan agreement. In subpart (c) of footnote 7 he incorrectly wrote that the restrictions were applicable to Chadbourn "common stock", rather than its "capital stock." This error in Chadbourn's 1969 Annual Report went undetected by Freeze, by the lawyers for both Chadbourn and Standard, and by other accountants who reviewed the financial statements (2028a-29a). Petitioners' own expert testified with respect to the mistaken use of "common" that

> "at the time of the financial statements themselves, as of August 2, 1969, and when the opinion was rendered, there was very little preferred stock outstanding, so that this is a matter of immateriality probably. I mean, it is a mistake technically, it should have said capital, but it's not a material error." (1206a)*

Chadbourn's financial statements were reprinted in the back of the March 27, 1970 Standard proxy statement. Chadbourn's outside counsel, Herbert Browne of the Charlotte firm Helms, Mulliss & Johnston,** noticed the footnote

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earnings plus all future earnings available for that purpose and would expire in 1974 (A-5) one year before the 1975 date when Chadbourn would begin to redeem some of petitioners' stock.

* At the time Chadbourn had outstanding only an immaterial amount of preferred stock the annual dividends on which amounted to approximately $13,000 (741a). Redemption of all of the shares of such Chadbourn preferred stock would have required only $226,999 (*see* 2204a; 2705a).

** The dissenting opinion in the court of appeals erred in referring to Browne as "Peat's attorney" (A-40) and "Peat's own lawyer" (A-41). Petitioners' counsel by letter (a copy of which is annexed as an appendix to this brief) informed the court of appeals of this error in the dissenting opinion, which they had quoted

error at the 46th page of the proxy statement and telephoned Freeze to inform him of it. Browne also informed Freeze, who had not received a copy of the forepart of the proxy statement, that a correct description of the restrictions had been inserted up front in the text of pages 6 and 7 prior to mailing the proxy statement (A-10; 2044a-47a; 2075a). Freeze corrected the footnote error, changing the word "common" to "capital" in two subsequent proxy statements for proposed transactions between Chadbourn and Continental Strategies Corp. ("Continental") and United Hosiery Mills ("UHM") (2591a; 2532a).

That change was a post-mailing correction of "common" to "capital", as petitioners conceded in the court of appeals. There never was any change of the word from "capital" to "common" as petitioners now claim (Pet. p. 5).*

Standard's management, which was aware of the restrictions on Chadbourn's retained earnings (A-11; 593a-96a; 608a), determined to vote in favor of the exchange with Chadbourn and set forth their voting decision and recom-

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in a suggestion for rehearing, pointing out that "the word 'Peat's' should be 'Chadbourn's' " and that "Mr. Browne was actually attorney for Chadbourn." Petitioners nevertheless repeat the dissent's mistaken reference in their petition (Pet. p. 16).

* The district court apparently believed that the Continental proxy statement was drafted first and that the Chadbourn financial statements in the Standard proxy statement were a mark-up of those in the Continental proxy statement. Having made that error, the district court relied upon as "determinative" (A-57-58) the use of the correct term in an "early draft" of the Continental statement as evidence of guilty knowledge by PMM (*ibid.*). But that chronology is wrong, as is apparent from the documentary record (*e.g.*, 2220a, 2241a; 2710a-11a; 3403a; 2591a), as was demonstrated by PMM in its brief in the court of appeals (at pp. 36-40) and as petitioners acknowledged in the Pre-Trial Order, which provided that Freeze "utilized copies of the printed Standard footnotes in drafting the Continental footnotes" (209a) and not vice-versa.

mendation up front in the text of the Standard proxy statement (2667a-68a; 2672a). They, their families and other insiders, collectively owned up to 40% of Standard stock and obviously did not consider the restrictions significant. Petitioners testified that in deciding to approve the exchange of stock transaction, they

> "relied entirely upon the judgment of the management of Standard Knitting Mills. I thought that they would not recommend to stockholders anything that was not to their advantage." (547a-48a; *accord,* 632a-35a; 640a-41a; 643a-44a; 646a-47a; 659a; 663a-64a).

While Standard lost money in 1969, Chadbourn had experienced increased earnings in 1967-1969. Petitioners understood:

> "that any concern that did not make money would not pay dividends, but I did not think Chadbourn would [not make money]." (550a; *accord,* 637a; 656a-57a; 659a-60a; 664a).

Not one of the petitioners testified to having read and relied upon or been misled by footnote 7 at the back of the proxy statement. The district court dismissed petitioners' cause of action under § 18 of the 1934 Act because they had failed to prove reliance (A-98).

On May 27, 1970, several weeks after the exchange transaction, petitioners as Chadbourn stockholders received the UHM proxy statement, wherein the footnote error had been corrected by Freeze. Mrs. Adams, the representative of the petitioner-class, was "sure" that she read the financial statements in the UHM proxy statement which contained this correction (550a-51a). No complaint was registered at that time; the market price of the Chadbourn stock petitioners acquired had remained stable since the date of the

exchange transaction and, following the footnote correction, increased slightly (3209a).

Chadbourn continued to make money in 1970, with a net profit at year end August 1, 1970 of over $1.3 million (2263a). Two years after the August 2, 1969 financial statements in issue and one and one-half years after the April 1970 exchange transaction, however, "the bottom dropped out of [the] hosiery market" (A-6) and Chadbourn announced in September 1971 a loss of $17,000,000 which wiped out its retained earnings and left it with a capital deficit. Announcement of the loss was followed by a decline in the price of Chadbourn stock and led, over a year later, to the institution of this lawsuit on October 12, 1972 (651a-54a; 551a). Petitioners conceded at trial, in response to PMM's offer of proof, that the 1971 loss was not related to their claim against PMM (1993a-99a).*

After the district court certified the action for class action treatment under Fed.R.Civ.P. 23, Standard, Chadbourn and the other defendants, except PMM, entered into a settlement agreement with petitioners whereby petitioners acquired a controlling interest in a reorganized Chadbourn (121a, 138a-42a; 158a-61a). Freeze, the author of the alleged fraudulent footnote 7(c), was retained as Vice President and Treasurer of the reorganized Chadbourn, and held that position at the time of the trial of this action against PMM (281a-83a; 1999a-2002a).

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* As the court of appeals observed (A-4), the disaster which struck the hosiery market was so large that Chadbourn could not have paid dividends or redeemed its stock even if there had been no contractual restrictions. The 1971 loss reflected price cutting and foreign competition in the hosiery market (3562a) which affected in 1972 a precipitous decline in the market price of most textile stocks (3558a-2). The Standard proxy statement had said that "the increase in demand for hosiery . . . has been remarkable, and there can be no assurance that the current popularity of panty hose will continue." (2691a)

The district court acknowledged that there was no evidence that the footnote error affected the price of Chadbourn stock (A-104), yet awarded damages equal to the entire decline in the price of Chadbourn stock subsequent to petitioners' purchase. It held that "[PMM] is not absolved of liability by asserting plaintiffs did not rely" on the footnote (A-92).

The court of appeals reversed on the ground that the finding of scienter was clearly erroneous and that the footnote error was "minor." It did not reach the additional issues raised by PMM concerning the elements of reliance, loss causation and the statute of limitations. In particular, the court of appeals did not reach the issue posed by PMM's argument that "the specific remedy provided by section 18 [of the 1934 Act] precludes implication of a cause of action under either section 10 or section 14, when the requirements of section 18 are not met." (A-13 n.6)*

* A copy of pages 8-10 of PMM's brief in the court of appeals setting forth the questions presented there is annexed beginning at page 3A as an appendix to this brief. There were also findings made by the district court with respect to the methodology used by PMM in its audit which were reversed by the court of appeals and which are not subject to any questions here.

I

The Decision of the Court of Appeals to Reverse a Judgment Under Section 10(b) Where the Evidence Showed a "Minor Error" and Negligence "At Most" Does Not Present A Question Justifying Review by This Court.

As has already been shown (p. i, *supra*), the "Questions Presented" posed by the petitioners are not in fact presented on this record. In addition, as is demonstrated here and in Point II, there is no conflict between the decision of the court of appeals and any decision of this Court or any other court of appeals. Further, as is demonstrated in Point III the holding of the court of appeals that the finding of scienter by the district court was clearly erroneous does not warrant review.

In *Ernst & Ernst* v. *Hochfelder*, 425 U.S. 185 (1976), this Court held that an action for damages will not lie under § 10(b) in the absence of proof of an "intent to deceive, manipulate, or defraud" (425 U.S. at 193), and that a complaint under § 10(b) should be dismissed when "respondents conceded that they did 'not accuse Ernst & Ernst of deliberate, intentional fraud,' merely with 'inexcusable negligence'" (425 U.S. at 190 n.5).

Petitioners assert (Pet. p. 10) that "knowledge" is sufficient to establish scienter, but the *Hochfelder* standard is "knowing or intentional *mis*conduct," 425 U.S. at 197 (emphasis added)—the issue is what is it that is "known." The court of appeals said "[a]t most the evidence supports a finding that Peat acted negligently" (A-10). Even when Freeze learned of the mistake in the footnote it appeared to be and was a "minor error" (A-11). That ends any inquiry under *Hochfelder*.

Petitioners ignore these conclusions and claim that the court of appeals erred because it "defined scienter as embracing a 'desire to deceive' " and noted the absence of any proof of a "purpose or desire" on PMM's part to mislead (Pet. pp. 9-10). Concededly the footnote was inaccurate, and the question was whether there was sufficient proof on the record to support the district court's finding that the inaccuracy was the result of deliberate deception by PMM, or rather a slip of the pen, a mistake, a failure to foresee a problem. In analyzing that issue the court of appeals asked, first, whether there was any reason for PMM to *want* to deceive Standard's shareholders, and it found that there was no proof of any such motivation on PMM's part.

Moreover, the court of appeals concluded that the matter misdescribed was not such as would have led the author of the mistake when he came to know of it to view it as material.

> "Freeze did not foresee that the bottom would drop out of Chadbourn's earnings and that what appeared to be a minor error at the time would become a major bone of contention." (A-11)

Rather than constituting any departure from this Court's holding in *Hochfelder*, the court of appeals' approach was a precise application of that holding.

Petitioners' reference (Pet. p. 11) to the statement in *Hochfelder* that the Court did "not address here, the question whether, in some circumstances, reckless behavior is sufficient" (425 U.S. at 194 n.12) has no relevance to this case. While most courts of appeals have adopted a recklessness standard in some circumstances, no court has equated recklessness with negligence. *See, e.g., McLean* v. *Alexander*, 599 F.2d 1190 (3d Cir. 1979), upon which peti-

tioners rely (Pet. p. 11), where the Court of Appeals for the Third Circuit reversed a post-trial judgment for plaintiffs in a § 10(b) action against accountants. The Third Circuit accepted that under *Hochfelder* "negligence—whether gross, grave or inexcusable—cannot serve as substitute for scienter" (599 F.2d at 1198).*

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* *Compare* the decisions from other courts upon which petitioners rely. In *Edward J. Mawod & Co.* v. *SEC*, 591 F.2d 588, 595 (10th Cir. 1979), defendants engaged in actions "designed to raise the price of the stock" and the court held that evidence of "[k]nowledge of the illegality of the scheme is, of course, essential. . . ." In *Rolf* v. *Blyth, Eastman Dillon & Co.*, 570 F.2d 38, 47 (2d Cir.), *cert. denied*, 439 U.S. 1039 (1978), the defendant fiduciary was informed that his principal's investment adviser was purchasing "junk" stocks for the principal's account and yet "constant[ly] reassur[ed]" the principal that such stocks were "satisfactory." In *Nelson* v. *Serwold*, 576 F.2d 1332, 1337-38 (9th Cir.), *cert. denied*, 439 U.S. 970 (1978), defendants knew the price at which they had offered to purchase stock from plaintiff was far below value and had "[k]nowledge of plaintiff's assumption that [it] represented the fair market value. . . ." In *SEC* v. *Falstaff Brewing Corp.*, [Current] CCH Fed.Sec.L.Rep. ¶ 97,505 (D.C.Cir. 1980), the court rejected the defense that defendant did not know his actions were in violation of certain law because he had admitted that "he thought that the [proxy] statement was fraudulent" and "elected to say nothing about it" (*id.* at 97,633). Indeed, the SEC had informed the defendant prior to distribution that it deemed a proxy statement to be "materially deficient" but the defendant amended it to say "the [SEC] had 'no comment' on the proxy statement" (*id.* at 97,639). The court held that whether or not the defendant had knowledge of the legal "labels" which would be placed on the facts was not relevant because he had knowledge of the "consequences of those actions" sufficient to support a finding of scienter (*id.* at 97,641). No such evidence was adduced by petitioners in this case.

II

The Decision of the Court of Appeals to Reverse a Judgment Against Independent Accountants Under Section 14(a) Where the Evidence Showed a "Minor Error" and Negligence "At Most" Does Not Present A Question Justifying Review by This Court.

The court of appeals held that the footnote error was a "minor error at the time" (A-11). There can be no liability under § 14(a) on the part of anyone for an immaterial misstatement. *TSC Industries, Inc.* v. *Northway, Inc.*, 426 U.S. 438 (1976). Accordingly, even if petitioners' questions concerning the standard of culpability arose on this record, the outcome in the court of appeals would not change.

Even if a material error had been involved, the decision of the court of appeals concerning liability under § 14(a) on the part of independent accountants is consistent with decisions of other courts which have addressed the issue in similar contexts. "Section 14(a) imposes liability on individuals soliciting proxies, and not on the attorneys or accountants preparing them." *Browning Debenture Holders' Committee* v. *DASA Corp.*, 72 Civ. 1332, at 4 (S.D.N.Y. 1975), *aff'd in relevant part*, 560 F.2d 1078 (2d Cir. 1977), *Accord, In re Clinton Oil Co. Securities Litigation*, [1977-78] CCH Fed.Sec.L.Rep. ¶ 96,015 at 91,576 (D. Kan. 1977); *Gould* v. *American Hawaiian Steamship Co.*, 351 F.Supp. 853, 866 (D. Del. 1972).

The court of appeals noted that "section 18 of the 1934 Act, dealing with misstatements in reports filed with the SEC, requires both scienter and reliance for civil liability" and "proxy materials must be filed in advance of the solicitation with the SEC, *see* 17 C.F.R. § 240.14a-6." (A-13 n.6) Section 18 of the 1934 Act, unlike § 14(a), applies to "any person who shall make or cause to be made a misleading

statement" in, *inter alia,* a proxy statement, and it was expressly contemplated that § 18 would provide the cause of action for misstatements by accountants contained in filed reports.* On the other hand, § 14(a) was thought to be addressed only to election proxy contests and the like, not to accountants, nor was it thought to create any civil liability. When, in 1934, the accounting profession presented its views with respect to the dimensions of private liability under the 1934 Act it addressed itself to § 18 and it objected to the original version which contemplated a negligence standard "on the ground that liability would be created for honest errors in judgment," *Hochfelder,* 425 U.S. at 211 n.31. The standard accordingly was changed to its present formulation imposing liability only for scienter.

As petitioners state (Pet. p. 15), the court of appeals "placed particular emphasis on its perception of the respondent's liability . . . as being one of secondary liability." Traditional concepts of secondary liability require proof that the defendant has "knowingly" and substantially assisted "a securities law violation" by another.**

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* *See Hochfelder,* 425 U.S. at 211-12n.31; Conf. Rep. to H.R. 9323, H.R. Rep. No. 1838, 73d Cong., 2d Sess. at 36 (1934); 78 Cong. Rec. 8040 (1934) (remarks of Rep. Rayburn and Rep. Hollister).

** *SEC* v. *Coffey,* 493 F.2d 1304, 1316 (6th Cir. 1974), *cert. denied,* 420 U.S. 908 (1975). *Accord, Hirsch* v. *du Pont,* 553 F.2d 750, 759 (2d Cir. 1977) ("knowledge of the fraud, and not merely the undisclosed material facts, is indispensable" to establish aiding and abetting liability); *Woodward* v. *Metro Bank,* 522 F.2d 84, 94-97 (5th Cir. 1975); *Landy* v. *FDIC,* 486 F.2d 139, 162-63 (3d Cir. 1973), *cert. denied,* 416 U.S. 960 (1974). In *Investors Research Corp.* v. *SEC,* 628 F.2d 168, 176-78 (D.C. Cir. 1980), the court affirmed an order censuring the principal defendant for negligent violation of § 17 of the Investment Advisors Act but reversed the order as to the alleged aider and abettor because of the absence of evidence of the requisite "state of mind". The court held that as to the alleged aider and abettor there must be evidence of "knowledge of wrongdoing" and "awareness that [the aider and abettor] was assisting . . . in wrongful conduct."

Petitioners say (Pet. p. 14) that "[t]o petitioners knowledge, except for the decision of the panel in this case, no other federal court has ruled that scienter, rather than negligence, is required," citing *Gould* v. *American-Hawaiian Steamship Co.*, 535 F.2d 761 (3d Cir. 1976). In fact, the court in *Gould* held that substantial shareholders who had designated members of the Board of the company which engaged in a proxy solicitation—persons more closely associated with the soliciting company than independent accountants—could be liable under § 14(a) only as "aiders and abettors." The test it laid down was that:

> "plaintiffs would have the burden of proving the doing of a wrongful act, the alleged aiders' and abettors' knowledge of it and their knowing and substantial participation in the wrongdoing." (535 F.2d at 779)*

The district court below held that PMM had acted with scienter and "therefore aiding and abetting a proxy solicitation" (A-97). The court of appeals, however, found no evidence of any "knowing or reckless wrongdoing" on the part of PMM (A-14).

Petitioners say (Pet. p. 15) that the application of standards of secondary liability in this case conflicts with *Standefer* v. *United States*, 100 S.Ct. 1999 (1980). They do not explain the pertinence of *Standefer* which involved a statute which expressly rendered "all participants in conduct violating a federal criminal statute . . . 'principals'," 100 S.Ct. at 2006, referring to 18 U.S.C. §2 (1976).

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* In *Gerstle* v. *Gamble-Skogmo, Inc.*, 478 F.2d 1281, 1298 n.16 (2d Cir. 1973), which petitioners also cite (Pet. pp. 14-15), the court made it clear that it was not passing "on the principles that should govern liability [under § 14(a)] of directors and other individuals having some responsibility for [a proxy] statement, as distinguished from a controlling corporation which has been the beneficiary of the action that was induced." *See also Hochfelder*, 425 U.S. at 209 n.28.

No such statute exists in respect of civil liability under the federal securities laws.*

Section 14(a) forbids the solicitation of proxies in contravention of such rules as may be promulgated by the SEC. It does not set forth the degree of culpability required to violate it. The SEC Rule 14a-9 tells us nothing of Congressional intent. There is no analogy to be drawn (*see* Pet. pp. 13-14) between that Rule and the statute involved in *Aaron* v. *SEC,* 100 S.Ct. 1945 (1980). As this Court responded to a similar attempt to divine congressional intent from an SEC rule, "[t]he rulemaking power granted to an administrative agency charged with the administration of a federal statute is not the power to make law," *Hochfelder,* 425 U.S. at 213.

The legislative history reveals that in enacting § 14(a) Congress intended to protect existing shareholders of a corporation from the same manner of "manipulative," "unscrupulous" and "promiscuous" conduct in the context of contests for corporate control as it had proscribed in

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* Petitioners also cite to *SEC* v. *Coffey, supra,* 493 F.2d 1304, as support for their assertion that an accountant can be "a primary participant in a violation" (Pet. p. 15), but do not explain that it involved an action under § 10(b) which, in contrast to the limited focus of § 14(a), applies by its terms to "any person" who "use[s] or employ[s], in connection with the purchase or sale of any security . . . any manipulative or deceptive device."

In *Hochfelder* this Court left open the question whether liability may be assessed against aiders and abettors in private civil actions under the federal securities laws, 425 U.S. at 191 n. 7, and thus it is unclear whether there is any basis at all to hold an independent accountant liable under § 14(a). In 1959 the SEC proposed that Congress add aiding and abetting provisions to the 1933 Act and the 1934 Act, but even then made it clear that those provisions would only apply to SEC administrative proceedings or enforcement actions and that "no civil liability is intended." *SEC Legislation: Hearings on S. 1178, et al. Before a Subcomm. of Sen. Comm. on Banking and Currency,* 86th Cong., 1st Sess. at 288 (1959). The Senate passed such a bill, S. 3769, 3770, 86th Cong., 2d Sess. (1960), but the House never voted on it.

§ 10(b) in connection with purchases and sales of securities, *see* A-14-15. This intent is confirmed by the legislative history of § 14(e), *see* A-15-17. The court of appeals correctly concluded (A-13, A-17) that it was particularly appropriate to apply such a standard in this case against independent accountants.

III

The Decision of the Court of Appeals That the District Court's Finding of Fraud Was "Clearly Erroneous" Does Not Present A Question Justifying Review by This Court.

This Court has held that "'A finding is "clearly erroneous" when although there is evidence to support it, the reviewing court on the entire evidence is left with the definite and firm conviction that a mistake has been committed.' *United States* v. *United States Gypsum Co.*, 333 U.S. 364, 395." *Commissioner* v. *Duberstein*, 363 U.S. 278, 291 (1960).

The court of appeals reviewed the entire record, which was extensively briefed by the parties, and concluded that the district court's finding of fraud was "clearly erroneous" (A-10). All that petitioners present here is the dissenting judge's view of the evidence with respect to the issue of scienter.

A writ of certiorari should not be issued "merely to give the defeated party in the Circuit Court of Appeals another hearing," *Magnum Import Co.* v. *Coty*, 262 U.S. 159, 163 (1923), or "to review evidence and discuss specific facts," *United States* v. *Johnston*, 268 U.S. 220, 227 (1925).

CONCLUSION

The petition should be denied.

Respectfully submitted,

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November 20, 1980

APPENDIX

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MACEY & ZUSMANN
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May 16, 1980

Mr. John P. Hehman, Clerk
Office of the Clerk
United States Court of Appeals
for the Sixth Circuit
Room 502
Post Office and Courthouse Building
Cincinnati, Ohio 45202

Re: CASE No. 78-1111-2

Mary Lillian Adams, et al., Plaintiffs-Appellees,
Barry J. McKean, et al., Paul W. Mankin, et al.,
Intervenors-Appellees,

vs.

Standard Knitting Mills, Inc., et al., Defendants,
Peat, Marwick, Mitchell and Company, Defendant-
Appellant

Dear Mr. Hehman:

Please note to the Court that, on page 9, line 5 of the SUGGESTION FOR REHEARING EN BANC AND PETITION FOR REHEARING, filed May 15, 1980, the word "Peat's" should be "Chadbourn's".

The quotation itself is accurate, but Mr. Browne was actually attorney for Chadbourn (App. 709a, 2044a, 2271a, 2595a).

Very truly yours,

/s/ JOHN M. SIKES, JR.
John M. Sikes, Jr.
Attorney for Plaintiffs-Appellees

JMSjr:mc
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"Questions Presented", From Pages 8-10 of the Brief of Respondent Peat, Marwick, Mitchell & Co. in the Court of Appeals

1. As to the footnote: Was the footnote to Chadbourn's August 1969 financial statements materially misleading in view, *inter alia,* of the accurate description of the pertinent restrictive covenants in the forepart of Standard's 1970 proxy statement? Was the footnote materially wrong when the Chadbourn preferred stock was not outstanding at the date of Chadbourn's August 1969 financial statements to which PMM's 1969 opinion related? Were there material restrictions on the redemption of Chadbourn's preferred stock? Did PMM intend to deceive the Standard stockholders?—Point I, *infra.*

2. As to Chadbourn's computer operations: Did PMM have a duty to publicly disclose weaknesses in Chadbourn's internal controls? Were there material weaknesses in Chadbourn's internal controls which affected the reliability of its accounting records? Did PMM intend to deceive the Standard stockholders?—Point II A, *infra.*

3. As to PMM's audit: Does failure to completely adhere to generally accepted auditing standards ("GAAS") provide the basis for a fraud action against accountants in the absence of any showing that the financial statements they examined were inaccurate? Did PMM's audit fail to comply with GAAS? Did PMM intend to deceive the Standard stockholders?—Point II B, *infra.*

4. As to proxy solicitation: Did the inclusion of PMM's opinion concerning Chadbourn's 1969 financial statements in the 1970 proxy statement constitute PMM an aider and abettor of a wrongful proxy solicitation, when no liability

on the part of Chadbourn, Standard or anyone else was found? Is there an implied right of action under Section 14(a) for the purchase of stock in a merger when an express right of action is provided by Section 18 of the 1934 Act? Point III, *infra.*

5. As to reliance and causation: May it be conclusively presumed that Standard's stockholders relied upon the footnote or PMM's opinion, despite the uncontroverted evidence to the contrary and the district court's dismissal of the express cause of action provided plaintiffs by Section 18 of the 1934 Act because they failed to prove reliance upon the matters complained of? May plaintiffs whose express cause of action under Section 18 has been dismissed for want of proof of reliance recover under an implied cause of action under either Section 10(b) or Section 14(a) by conclusively presuming reliance to follow from materiality? Is an action founded upon an accountant's opinion one involving primarily non-disclosure or is it rather one of misrepresentation where proof of reliance is required?—Point IV, *infra.*

6. As to injury and damages: May PMM be held liable for the decline in the price of Chadbourn's stock in the two and one-half years between the date of the merger and the date the action was filed?—Point V, *infra.*

7. May the fees of plaintiffs' attorneys be assessed as a "penalty" against PMM? Was the award of prejudgment interest an abuse of discretion?—Point VI, *infra.*

8. Was plaintiffs' claim barred by the applicable statute of limitations?—Point VII, *infra.*